

ORIGINAL



Robert W. Quinn, Jr.
Federal Government Affairs
Vice President

Suite 1000
1120 20th Street NW
Washington DC 20036
202 457 3851
FAX 202 457 2545

EX PARTE OR LATE FILED
RECEIVED

November 14, 2002

NOV 14 2002

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Via Electronic Filing
Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, SW, Room TWB-204
Washington, DC 20554

Re: Ex Parte - CC Docket Nos. 01-338, 96-98, 98-147 In the Matter of Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers

Dear Ms. Dortch:

Yesterday, James W. Cicconi, General Counsel and Executive Vice President Law & Government Affairs, submitted the following letter to Federal Communications Commission Chairman Michael K. Powell, Commissioners Kathleen Q. Abemathy, Michael J. Copps and Kevin J. Martin. Please include a copy of this correspondence in the record of the referenced proceedings

Two copies of this Notice are being submitted in accordance with Section 1.1206 of the Commission's rules.

Sincerely,

A handwritten signature in cursive script that reads "Robert W. Quinn, Jr.".

Enclosure

No. of Copies rec'd 045
List ABCDE

ORIGINAL

RECEIVED

NOV 14 2002



FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

James W. Cicconi
General Counsel and
Executive Vice President
Law & Government Affairs

EX PARTE OR LATE FILED

Suite 1000
1120 20th St. NW
Washington, DC 20036
202 457-2233
FAX 202 457-2244

November 13, 2002

The Honorable Michael K. Powell
Chairman
Federal Communications Commission
445 12th Street SW, Suite TW-8B201
Washington, DC 20554

The Honorable Michael J. Copps
Commissioner
Federal Communications Commission
445 12th Street SW, Suite TW-8A302
Washington, DC 20554

The Honorable Kathleen Q. Abernathy
Commissioner
Federal Communications Commission
445 12th Street SW, Suite TW-8B115
Washington, DC 20554

The Honorable Kevin J. Martin
Commissioner
Federal Communications Commission
445 12th Street SW, Suite TW-8A204
Washington, DC 20554

Re: the National Telecommunications and Information Administration's on 25th Unbundling Obligations
of Incumbent Local Exchange Carriers, CC Docket Nos. 01-338, 96-
98 and 98-14'

Dear Mr. Powell and Commissioners:

In their filings in the referenced proceeding, the Bell Companies have sharply framed the issues before the Commission, dramatically underscoring the ramifications of the Commission's decision. In doing so, they have foretold the impact that the Commission's decision will have on the telecommunications industry. The choice before the Commission is stark: either continue down the path of incremental change in the manner and pace of reform, or to implement the Telecommunications Act of 1996, or it can, as the Bells urge, try improperly to find ways to shield their multi-modal business model from the competitive forces that have shaped the industry in the nearly seven years since the Act's passage.

The incumbents' proposals have four main components. First, they would promptly end competitors' access to unbundled switching and **the** UNE Platform (UNE-P), which, given the significant impairments CLECs face in the local market, has been the principal vehicle for bringing local voice competition to mass-market residential and **small** business customers. Second, they would deny access to facilities essential to enable CLECs to provide competitive broadband services, which are increasingly demanded by consumers. Third, they would generally deny access to high capacity loop and transport **UNEs** that competitive carriers use to provide telecommunications services to **medium** and large business customers, requiring carriers instead to purchase special access services from the Bells that are often up to twice as expensive. And finally, they would preempt State commissions -- which the Act establishes as key protectors of local competition in their respective jurisdictions -- from mandating any greater unbundling in their own markets. In short, adoption of the Bell proposals would materially and negatively impact every single customer class being served by CLECs today and in the **future**. Indeed, for a large segment of the **populace**, those proposals would eliminate competitive alternatives entirely. AT&T, for one, would have no alternative but to abandon virtually **all** of **the** approximately **2.5** million residential and small business lines it currently serves over UNE-P, and both CLEC customers and ILEC customers would **lose** the benefits that the existence of competition brings to the marketplace.

The Bell rhetoric **is** nothing short of an attack **on** the framework of the Telecommunications Act itself. Having practically achieved all of the benefit that the **Act** provided to the Bells -- entry into the long distance markets with the potential for billions of dollars in incremental revenue -- the **Bells** now seek to reverse **the Act's** requirement that they lease access to their local networks so that local and **all** distance services **can** become as competitive **as** long distance services before them. If the Commission elects to go down the road the Bell companies prescribe, it must do so with the full knowledge that such action would be a complete, unlawful repudiation of the **Act** and its competitive goals.

The **Act's** fundamental goal **is** to eliminate local and long distance **silos** and create a competitive environment where customers have multiple choices of providers that **sell** local, long distance, and all distance services. The framework Congress established reflected the Nation's experience in the long distance marketplace, in which the Commission established resale requirements (with significant discounts available to competitors) and an automated customer migration PIC process that resulted in **both** facilities-based competition **and** the vibrant wholesale market **that** exists today. **In** fact, when the **Bell** companies enter the long distance market, they do so largely through resale of long distance facilities obtained at steep wholesale discounts -- **not through facilities investments**. The all distance marketplace envisioned by the Act is one in which ILECs **and** CLECs **alike** would participate by leasing facilities from their competitors for a portion of their offering and self-providing facilities where it is economically rational to do **so**. Indeed, all telecommunications carriers provide services in a similar manner. Wireless carriers, cable companies, and hundreds of other carriers compete in the marketplace by self-providing facilities where they have them and leasing other carriers' facilities where they don't. Under the Bell's view, all of this competition would have to be dismissed **as**

“synthetic.” In reality, however, that is the exact progression towards competitive markets envisioned by the Act.

The same policies that enabled long distance competition were the **very** foundation for the 1996 Act, which created three entry paths for competitors seeking to compete in the all distance world – facilities builds, **UNEs**, and resale. The very language of the Act recognized that competitive carriers could not replicate **the** incumbents’ local facilities nationally overnight, just as **new** long distance competitors were not able to replicate AT&T’s national network overnight. The Act was based on the core understanding that competitors would require access to incumbent facilities at cost-based rates in order to compete with the entrenched local monopolies and **it is** that **fundamental** tenet that the **Bell** companies would have this Commission repudiate here. The Act also required non-discriminatory access to local network facilities, just as the equal access requirement before it created a non-discriminatory customer acquisition and provisioning process in the long distance market.

In the end, the Bells’ rhetoric is designed to lead the Commission down the path of eliminating the one local entry mechanism that affords competitors the local equivalent to equal access necessary to compete for mass-market residential and small business customers – the UNE-Platform. **In** the years immediately after the Act was **passed**, while the Bells kept the bulk of the Act (and especially **UNE-P**) tied up in litigation, residential and small business customers saw virtually no competitive alternatives emerge precisely because CLECs faced significant economic impairments **in** their attempts to address those markets using a facilities-based strategy. Yet the incumbents continue to assert that the presence of CLEC switches alone means that CLECs **can** effectively serve small business and residential customers, and the elimination of access to the local switching UNE (and UNE-P) would therefore not impair mass-market competition.

But the undisputed facts developed in this proceeding establish that CLECs **seeking** to connect customers’ loops to a CLEC switch inherently incur substantial costs (due to hot cut **and** backhaul processes and costs) that the incumbent does not, and that CLECs incur significantly higher unit costs than the incumbent over whatever percentage of the market **they** serve. These cost penalties, together with the degraded service quality associated with the manual hot cut process, erect absolute economic barriers to the provision of mass-market services to small business and residential customers through the use of unbundled loops and self-provisioned switches. By contrast, the only customers that can be economically served through these manual arrangements are generally high volume customer locations served by **DS1** and higher capacity local loops, and competitive local switches today overwhelmingly serve only those high capacity loops. Indeed, those are the **only** customer segments that saw any significant competitive alternatives before UNE-P became available.

Recently, however, meaningful opportunities for mass-market competition have emerged through the use of UNE-P. By the end of the year, almost 11 million residential and small business lines will be served by carriers utilizing UNE-P. **And** these customers **are** not located only in the high-density urban zones, but they are spread across the market including suburban and rural areas. By SBC’s own count, CLECs serve over 1 million

lines in the least dense zone in SBC's territory alone.' **As** a result, residential and small business customers are beginning to see the competitive benefits long promised but long denied after the Act's passage.

Make no mistake, **this** competition, along with the lower rates and greater choices it has spawned, will disappear if **UNE-P** is eliminated. AT&T **will** be unable effectively to serve residential and small business markets in the face manual hot cut processes, and **will** be relegated primarily to serving large business customers at the DS1 level **or** above. Indeed, if CLECs are prevented from serving the small business and residential markets, all consumers -- from large business customers to single line rural customers -- will see fewer competitive companies offering alternatives as the eroded CLEC customer bases make it more difficult for CLECs to scale their businesses and maintain and expand their competitive presence. And by eliminating AT&T and other CLECs as viable local competitors in the residential and small business markets, the Bells will also achieve insuperable advantages in the all distance market -- the very reason why they were denied entry into the long distance business in the first place.

AT&T has already filed an extensive package of data and economic, legal and policy analyses that highlights the impairment issues and points to the inescapable conclusion that **UNEs** generally, and **UNE-P** in particular, must be retained **until** the Commission resolves the last-mile connectivity and related economic problems that continue to impair competitors' ability to provide the telecommunications services they seek to offer. This letter reviews **this** material, but first it addresses why the incumbents' proposal that the Commission preempt the State commissions from maintaining **UNEs** and **UNE-P** **is** as unlawful as it is bad public policy. Indeed, because States are in the best position to assess these issues, section 251(d)(3) expressly bars the Commission from adopting regulations that preclude enforcement of State unbundling requirements that are in **addition** to those that the Commission adopts and reflect the States' views **of** how best to promote the local competition that **is** the purpose of the Act.

Next, the letter discusses the record evidence demonstrating that there **exists** no conflict between unbundling and facilities investment. The development of local competition based on **UNEs** **is** beneficial in itself whether or not it leads to additional investment. But six years of marketplace experience now confirm that **UNE-based** competition **also leads to** greater investment.

Finally, this letter discusses, in detail, AT&T's proposal for analyzing impairment consistent with both the Supreme Court's decision in *Verizon*² as well as the D.C. Circuit's decision in *USTA*.³ In the end, the factual, legal, engineering and economic evidence presented in **this** record all point to the same result: **UNE-P** is as essential to competition in the mass-market small business and residential arena as wholesale long-distance networks are to the competitive long-distance market. To eliminate access to the former

¹ *SBC Ex Parte* (October 30, 2002).

² *Verizon Communications Inc. v. FCC*, 122 S. Ct. at 1646 (2002).

³ *United States Telecomm. Ass'n v. FCC*, 290 F.3d 415 (D.C. Cir. 2002)

for CLECs, while allowing the incumbents continued access to the latter would **serve** no purpose but the creation of four enormous all distance wireline monopolies, setting telecommunications policy in this Nation back a quarter century and ensuring the need for broad-scale local monopoly regulation for years to come.

State Unbundling Requirements **May Not Be Preempted**

Recognizing that State commissions vigorously support the broad availability of **UNEs** and firmly agree that **UNE-P** is essential to competition for both residential and small business customers: the incumbents' proposal to preempt the states is simply lawless. They contend that the Commission should not **only** revise its **own** rules in their favor, but also should preempt State commissions from maintaining or expanding **UNE** requirements under both Federal and State law. This claim squarely violates the Act and defies simple common sense.

The issue here is whether there can be *local* competition with the incumbents, and while there is a clear federal interest in this matter, State commissions have jurisdiction over these issues as well. In fact, they have exclusive jurisdiction to regulate the retail rates, terms, and conditions of the incumbents' local services, and they prescribe whether and to what extent particular **ILEC** rates provide or receive subsidies. And just as critically, the CLECs' ability to provide competitive service depends on the economic and engineering conditions applicable to each local **service** office. States are simply in a far better position than the Commission to determine the need for **UNEs** at particular prices in particular places and the effects of access to unbundled network elements on competition, on investment, and on incumbents.

The Act was enacted against the background of the efforts of several States to adopt regulations that would allow local competition to develop, and it expressly relies upon State commissions to implement the federal mandates in accord with local conditions. Under the Act, the Commission adopts federal regulations that provide minimum national standards which all incumbents must meet, but the State commissions **set** **UNE** rates, apply the federal standards to local conditions, and adopt those additional State law requirements that they believe are necessary and appropriate to allow local competition to **flourish.**' By statute, State determinations under the Act are **not** reviewed by **the** Commission, but by a federal district court in that **State.**⁶

Because **of** the States' expertise and superior knowledge of local conditions, the Commission's prior regulations have specifically authorized State commissions to apply the "necessary" and "impair" standards and to require incumbents to provide access to

⁴ NARUC **UNE-P** Resolution (adopted Nov. 14, 2001) (attached to letter from Joan **Smith et al.** to Chairman **Powell** and Commissioners **Abemathy**, **Copps** and **Martin**, CC Docket No. 96-98 (December 5, 2001)).

⁵ 47 U.S.C. §§ 251(a) – (d).

⁶ *Id.* § 252(e)(6).

UNEs beyond those the Commission has established **as** national minima. Notably, even when the unbundling requirements of specific Commission regulations were invalidated on direct review by federal appellate courts on the ground that they were unauthorized by § 251, the courts held that States can impose the **same** or greater requirements under state law.⁷

But the decisive fact here is that § 251(d)(3) of the Act expressly **burs** any attempt by the Commission to adopt regulations that preempt States from adopting unbundling requirements beyond those that the Commission has imposed. This section provides that, in adopting its regulations, the Commission cannot preclude enforcement of any State access and interconnection regulation, order, or policy that is “consistent with the requirements of Section 251” and does not “substantially prevent implementation of the requirements of [§ 251] and the purpose of [§§ 251-261] of the Act.”

Thus, even if the Commission were to adopt federal regulations that impose lesser unbundling requirements, State rules that require access to **UNEs** and **UNE-P** are preserved from preemption. Such measures are obviously consistent with the pro-competitive requirements of § 251 and do not substantially impede their implementation, for additional unbundling requirements neither prohibit nor impede the implementation of the unbundling requirements of § 251. Rather, they merely require *additional* measures that the incumbent must take under state law and for which the incumbent is fully paid. It is elementary that where it is “possible to comply with the state law without triggering federal enforcement action,” the state requirement “is not inconsistent with federal law.”⁸

Similarly, State rules that adopt **UNE** and **UNE-P** unbundling requirements do not substantially impede implementation of the purpose of §§ 251-61 of the Act. Their purpose is to promote local competition, and the State unbundling measures have exactly the same purpose. In this regard, it would be entirely beside the point if the Commission were to accept the incumbents’ unsubstantiated claim that greater unbundling requirements can reduce facilities investment or impose other costs and that the correct “trade off” as a matter of federal policy is to limit unbundling in order to foster greater facilities investment? Even if that were a rational policy judgment for the Commission to make – **and** AT&T maintains it is not given the extensive record here – § 251(d)(3) prohibits the FCC from substituting its judgment on the matter in place of that of the State commissions. Section 251(d)(3) measures the validity of State unbundling rules by their consistency with the **Act’s** purposes, not with the **Commission’s** purposes in adopting its regulations. Where, as here, there is a reasonable basis for finding that CLECs *are* impaired without unbundled switching and other **UNEs** and where a State makes different policy judgments than this Commission on the relationship between unbundling rules and facilities competition and the appropriate “tradeoffs” to address that relationship, the State rule **can**, at most, be inconsistent with the Commission’s regulations. But such a State rule is plainly consistent with **the** Act and cannot be held substantially to impede implementation of its

⁷ *US West Commun. Inc. v. MFS Intelenet, Inc.*, 193 F.3d 1112, 1121 (9th Cir. 1999).

⁸ *Jones v. Rath Packing Co.*, 430 U.S. 519, 540 (1977).

⁹ *Accord, USTA*, 290 F.3d at 424-25.

purposes. To the contrary, the State rule will simply **reflect** measures that a **differently** constituted Commission could have **lawfully** adopted and that is thus consistent with the Act and its purposes.

In this regard, the Act otherwise makes clear that unbundling requirements in addition to those imposed by the FCC's § 251 regulations are wholly consistent with the Act's requirements and do not substantially impede implementation of its purpose. The Act authorizes incumbent LECs to voluntarily agree to additional unbundling requirements, and these requirements must be upheld **unless** they are discriminatory or contrary to the public interest." Similarly, § 271 independently requires BOCs who seek and exercise long distance authority to provide unbundled loops, switching, transport, and signaling, whether or not they **are** designated as network elements that must **be** made available in accord with §§ 251(c) and 252(d)(2).¹¹ Because other provisions of the Act permit or require greater unbundling obligations than the Commission's general unbundling regulations impose, it is patent that additional State unbundling requirements are consistent with the Act, cannot impede implementation of its requirements or purpose, and are immune from preemption under § 251(d)(3).

Finally, while it is clear today that CLECs will be impaired **if they are** denied access to **UNEs** **in** accord with AT&T's specific proposals, the Commission should **now** frankly acknowledge that the States are better suited to determine whether and when **these** federal requirements should be modified in the future." The Commission simply lacks the resources necessary to collect and review the relevant information required efficiently and reliably to determine the extent of the impairments CLECs face in evolving and different local market conditions. Therefore the Commission's new **rules** should mandate the continued availability of UNEs in accord with AT&T's proposals, adopt specific criteria that must be satisfied for delisting any **UNEs** under federal law, and delegate those delisting determinations to the State commissions – while recognizing the States' right to adopt additional requirements under State law.

¹⁰ 47 U.S.C. §§ 252(a)(1) & (e)(1).

¹¹ *Compare* 47 U.S.C. § 271(c)(2)(B)(ii) (requiring "access to **network** elements in accord with the requirements of Section 251(c) and 252(d)" *with id.*, §§ 271(c)(2)(B)(iv)(v) & (x) (nondiscriminatory access to unbundled **loops**, unbundled **transport**, unbundled **switching** and databases and signaling). *See also id.* § 160(c) (Commission "may not forbear from **enforcing** requirements of Section 251(c) on 271" until **they are** "fully implemented").

¹² NARUC UNE-P Resolution (adopted Nov. 14, 2001) (attached to letter **from** Joan **Smith et al.** to Chairman **Powell** and Commissioners Abemathy, Copps and Martin, CC Docket **No. 96-98** (December 5, 2001)); NARUC Reply **Comments** (July 17, 2002).

UNEs And Investment

Because it is clear on the detailed record here that requesting carriers are indeed impaired if they are denied unrestricted and broad access to ~~the~~ loop, switching, and transport UNEs and to combinations of those elements, ~~the~~ Commission should adopt **new** regulations that require these UNEs to be made available without regard to any other considerations. Thus, the incumbents' arguments that unbundling reduces investment, even if true, could not be dispositive. Indeed, **although USTA** addressed effects of unbundling on investment, it did so only because the court determined that the Commission had ordered unbundling in many markets where the record underlying the **UNE Remand Order** had not provided a reasonable basis for the court to conclude that competition was suffering **from** impairment so that ~~the~~ court was addressing whether the national rules could be upheld on other grounds." This analysis is unnecessary and improper here, where it is clear -- based on an extensive factual record of recent market experience -- that CLECs will **be** impaired if access to **UNEs** is denied.

But the record now **also** makes clear that the incumbents' investment claims have no substance. The Supreme Court upheld the features of the TELRIC pricing rule **for** network elements on the ground that it is a reasonable method **to foster** prudent investment by CLECs and incumbents, and the Court **also** concluded that the massive CLEC and ILEC investments that occurred in the six years since ~~the~~ unbundling rules were adopted foreclosed any contrary **conclusion**.¹⁴ Of course, the D.C. Circuit has since held that the mere fact of substantial investment does not provide evidence on investment incentives, and thus whether greater investment may have otherwise occurred. But it is **undisputed** today that CLECs massively overinvested and made speculative investments that have indeed been proven to be wasteful. As a result, there can be no legitimate claims at **this** time that CLECs' right to UNEs and **UNE-P** at TELRIC prices has impaired any efficient investment by CLECs. To the contrary, ~~the~~ record refutes ~~the~~ baseless claims that the availability of leased facilities (particularly **UNE-P**) **has** discouraged CLEC investment.¹⁵

Nor does unbundling have any adverse effects on incumbents' investment. **As** the Supreme Court has held, TELRIC provides incumbents with a guarantee of recovery of the full economic **replacement** cost of their network facilities, including depreciation rates and returns on investment that reflect all the risks that incumbents face in the marketplace and under the TELRIC regime itself. TELRIC thus could not deter investment by incumbents, even if ~~they~~ were used to set all the incumbents' rates. Further, as the Supreme Court has held, because the TELRIC scheme stimulates CLECs' investment in alternative facilities, it is "commonsense" that it inherently also fosters investment by **incumbents**.¹⁶

¹³ *USTA*, 290 F.3d at 424-25.

¹⁴ *Verizon*, 122 S. Ct. at 1675-76 & n.33.

¹⁵ See AT&T Reply Comments, pp. 126-36, Clarke Dec. (July 17, 2002); AT&T Comments, pp. 40-61, Willig Dec. (Apr. 5, 2002).

¹⁶ *Verizon*, 122 S. Ct. at 1676 n.33.

The Bells' claim is also unsound **as** a matter of economics. Their claim is that unbundling deters investments because the unbundling **rules** compel ILECs to lease portions of their local exchange networks to **CLECs** at returns that are lower than they **can** earn when they use their networks to provide retail **services**. They assert that because their combined return from their local network investment is diminished, their incentive to invest is also diminished. **As** Professor Willig has explained, although this argument is "superficially appealing," it is "inconsistent with the basic economics of competition and monopoly."¹⁷

Whether a **firm** is a monopoly **or** faces competition, capital investment decisions are based on whether the anticipated incremental revenue that results from the capital investment exceeds the incremental cost of the unit of capital invested. The existence of effective competition may reduce the incumbents' total revenues, but it means that the incumbent's "marginal revenue is greater" and that capital investment **is stimulated**, because it is more likely to lead to increases in net marginal revenues. In contrast, a monopolist's incremental investment is more likely to reduce the prices paid by customers for its product, and thereby reduce its revenue on the margin. "The result is that incentives for investment and production of output are greater under the pressures of a competitive environment, and predictably the firm invests **more**."¹⁸

Critically, actual experience confirms this point. Professor Willig's detailed econometric study determined the actual empirical consequences of more attractive UNE rates on competitive behaviors by CLECs and on network investments by incumbents. It concludes, as an empirical matter, that the more attractive the UNE rates in a State, the greater the incumbent's investment, with 1% **reduction** in UNE rates corresponding to a **2.1% to 2.9% increase** in ILEC investment rates." This study is an updated version of an earlier study, and it made all the adjustments to the data that the incumbents and **other** critics of the earlier study suggested.

The Bells have thus now shifted gears yet again. They do not and cannot deny that massive overinvestment occurred in the telecommunications industry in the **six** years since the unbundling rules were adopted. But the Bells are **now** making other claims that are highly contrived and ultimately meaningless.

Their main new contention is that even though massive **CLEC** overinvestment occurred, this investment is not relevant to the **Commission's** decision, because "most" of the **CLEC** investment in States with a substantial number of UNE-P customers did not occur **after** UNE-P based services were rolled out on a significant scale. But the **basic** assertion is irrelevant, and the specific claims made by Mr. Barr are **erroneous**.

¹⁷ AT&T *Ex Parte*, Stimulating Investment and **the** Telecommunications Act of 1996 (Oct. 11, 2002) ("*AT&T Investment Incentive Ex Parte*") at 5.

¹⁸ *Id.* at 6.

¹⁹ *Id.* at 23-24.

First, as the Supreme Court has held, the relevant time frame to **assess** the-effects of unbundling is **the** entire six-year period since the requirements were adopted, *i.e.*, since August 1996.²⁰ That is because investment decisions are not made based on the services that are being offered at the time of the investment, but rather on the services that **will** be deployed over the investment's **useful** life. Competitors' rights to use **UNEs** and **UNE-P** at TELRIC prices were authorized in August 1996. It was then substantially certain that such arrangements would be used, and that assumption became progressively more and more certain over the coming years as the Bells' legal challenges to the **rules** were rejected, and as more and more States independently embraced the **use** of **UNEs** and **UNE-P** to support competition. Thus the relevant period for assessment begins in 1996, not at the January 1999 commercial introduction of UNE-P based services in New York, or the subsequent dates at which **UNE-P** based services were introduced in other States.

Second, even if the dates of commercial UNE-P services rollouts were relevant, it is simply meaningless that "*most* of the CLEC investment" in those States occurred before **UNE-P** was aggressively rolled out. CLECs deployed facilities to **serve** the customers that they believed could **be** served *without* **UNE-P**. Thus, these investments would not **be** deferred during the three to six year period between the adoption of the unbundling requirements and the rollouts of **UNE-P**.

Beyond that, there are finite and well-defined classes of customers that *can* be **more** readily and economically served through alternative facilities: *i.e.*, customers **served** by **DS1** and higher level loops and those in the approximately **60,000** buildings in the nation for which it might be economic to extend alternative fiber loops. Particularly given the absence of significant capital constraints between 1996 and 2000, the most attractive investments (the low hanging fruit) and practically all other investments that appeared feasible were made then. Further, in view of the massive overinvestment that has occurred and the severe capital constraints that apply today, it was inevitable there would be more facility investment in individual States during the first 3-6 years after 1996 **than** in the last few years.

The Bells also make specific allegations that are both false and **also** refute their **claim** that **UNE-P** inhibits facilities-based service to customers for which it would be economic. For example, Verizon's October 16, 2002 letter from William Barr to Chairman Powell (echoing the discredited allegation in the incumbents' "**UNE-P** and Investment" document) states that AT&T and WorldCom "invested **heavily** to deploy their **own** switches" in New York before the **January 1999** rollout of **UNE-P**, but that this deployment "declined precipitously" when AT&T and WorldCom began providing **service** through **UNE-P** in 1999. But that claim is factually false. AT&T's rates of switch deployment in New York **increased** after 1999, and the incumbents fabricated their contrary claim by misclassifying the toll switches that AT&T deployed prior to 1999 as local **switches**.²¹ Indeed, AT&T deployed more switches in New **York** between 1999 and

²⁰ *Verizon*, 122 S. Ct. at 1675-76.

²¹ See *AT&T UNE-P and Investment Ex Parte* at 5-7, 15-16

2001 than in it did in other large states (*e.g.*, California) where AT&T was not then able to use UNE-P.²²

Mr. Barr also notes that AT&T's initial business plan was to serve all business customers through **UNE-L**, and self-provisioned switching, but that AT&T and nearly **all** CLECs now **use** their switches to serve only locations with DS1 and higher capacity loops (and certain medium-sized customers who are initially served on UNE-P and moved to AT&T switches on a project basis). Thus, Mr. **Barr** ignores that AT&T clearly explained exactly why it changed its business plan, *i.e.*, because its actual marketplace experience demonstrated that it could not economically serve other business customers through its own switches due to the incumbents' poor hot cut performance and the financial penalties associated with hot cuts and **backhaul**.²³ Thus, AT&T and other CLECs have amply documented the undisputed fact that UNE-P is the only practical and economic means to **serve** the vast majority of customers served by voice grade loops.

The UNE Rebuttal Report also offers a contrived comparison that gives new meaning to the concept of lying with statistics. The Bells claim that their figures demonstrate that the presence of UNE-P deters cable providers **from** offering cable-based telephony. That is nonsense. Only two cable providers (Cox and AT&T Broadband) offer significant facilities-based competition for residential customers. But AT&T and Cox have substantial cable footprints in California, and no significant footprint in New **York**. Accordingly, the fact that there is relatively little cable-based telephony service in New **York** can hardly be a surprise, and cannot be attributed to the availability of **UNE-P** in that State, but rather substantially to the fact that AT&T and Cox have no significant cable footprint there.²⁴ Further, two States with cable telephony (California and Illinois) also now have growing UNE-P customer bases.

In this regard, the **Bells** continue to rely on a highly gerrymandered study that purports to show that there is an inverse relationship between UNE-P and network facilities investment by **CLECs**.²⁵ But the short answer to this is that the Bells *admit* that if their methodology and data were applied to all States, the conclusion would be that there is **no** significant relationship between CLEC investment and **UNE-P**.²⁶ Further, AT&T has already shown that the incumbents can only reach a different result by using a contrived subset of States. And the study is a sham even as applied to that subset, for the results **are** driven by estimates of CLEC line counts that bear no relation to the Commission's reported data and are derived from "sources" that are not public and methods that are

²² *Id.*

²³ See *generally* AT&T Comments, Brenner Dec. (Apr. 5, 2002).

²⁴ See *AT&T WE - P and Investment Ex Parte* at 13-14.

²⁵ See *id.* at 7-10.

²⁶ See *id.*

certain to substantially overstate the CLEC penetration.” Unsupported repetition of these contrived – and false – results cannot make them any more correct.

Finally, it is extremely ironic that the Bells would assert that gutting the UNE rules would lead to greater investments by incumbents by “restor[ing] the[ir] financial health.”²⁸ Local voice services are flat or declining, and incumbents have already installed facilities capable of serving 100% of the former demand. Although incumbents will **make** investments that will reduce their costs of providing serving (e.g. the Project Pronto loop upgrades that produce operational savings that pay for themselves) or to serve **new** developments, there otherwise **is** no prospect of increased investment in the local voice network under any scenario. Similarly, although the ILECs have made and are making substantial investments to offer DSL service,²⁹ the Commission has correctly found that these investments are being made in response to intermodal competition from cable services and the intramodal competition provided by data and other **CLECs**. And because there is no demand for fiber to the curb or other higher capacity broadband **services**, investments to provide these services will not be made under any scenario – as all **the** panelists at the October 7th *en banc* hearing agreed.

Finally, the incumbents’ assertions to the Commission are flatly contrary to the presentations that they have made to the financial community. The incumbents’ statements to the financial markets show that their investment decisions are **not** driven by regulatory rules but by other economic imperatives. Recent Bell statements – particularly those of Verizon itself – provide clear evidence that incumbents *can* compete **successfully** in the current unbundling environment, that they themselves recognize they have significant cost advantages over new entrants with respect to local facilities, and that changes in unbundling **rules** will not significantly **affect** their investment **policies**.³⁰

Key Principles Of Impairment

The principles that govern the Commission’s unbundling determinations are straightforward. Because the elements at issue are not “proprietary,” the statutory test for unbundling is not whether access is “necessary,” but rather is merely whether CLECs **will** be “impaired” in providing local services if access to a specific element is denied. Impairment thus requires a showing only that the effectiveness of competitors’ entry will be materially diminished if **UNEs** are unavailable.

²⁷ *See id* at 3-5.

²⁸ Barr Letter, at 1.

²⁹ AT&T **Reply** Comments at 79-81 (July 17, 2002).

³⁰ *See Ex Parte letter* from Joan Marsh to Marlene Dortch (Oct. 29, 2002).

Natural Monopoly “Characteristics.”

As made clear by the Supreme Court, the Act’s object is to allow entry by “hundreds of smaller entrants” and that unbundling is thus **re uired** even if there are some “large competitive carrier[s]” that can duplicate the **element**! And in *USTA*, the Court of Appeals stated that it “did not intend to suggest” that the Act requires “**use of the** criteria of the essential facilities doctrine” and permits unbundling of only those elements that can be provided by only a single **firm** as a matter of **economics**.³² Thus, contrary to the incumbents’ suggestion, *USTA* held only that a UNE must have “some degree” of the “characteristics” of a “natural monopoly” and that **the** question for the Commission is whether “competitive supply” of an element by “multiple” **firms** would be “**wasteful**.”³³

In this regard, while *USTA* held that the Commission applied an erroneous impairment standard in the *UNE Remand Order*,³⁴ this holding was quite narrow. The Court disapproved only **one** aspect of **one** of the kinds of cost disparities that the *UNE Remand Order* had addressed: the presence of economies of scale that apply only during initial stages of entry, that are universal as between incumbents and **new** entrants in **any** market, and that thus do not constitute entry barriers. By contrast, *USTA* did not disapprove the *UNE Remand Order*’s reliance on whether new entrants (1) have to **make** large investments that are both “**fixed**” and “**sunk**” because they will be wasted if entry is **unsuccessful**³⁵ or (2) must incur costs that the incumbent does not, such that the **new** entrant **will** have higher unit costs than the incumbent over **whatever** range of demand the new entrant experiences.³⁶

Indeed, under settled antitrust principles, it is **the** existence of these latter conditions that mean that facilities have natural monopoly characteristics and multiple competitive supply is **wasteful**.³⁷ The reality is that when these conditions exist, entry **will** **not** occur **unless** new entrants can enter through leasing arrangements that avoid inherent unit cost disadvantages, or that at least allow deferral of such investments until the entrant has acquired sufficient traffic volumes to make the sunk investments rational. In this connection, *USTA* and *Verizon* call for a quite traditional antitrust analysis, analogous to that under the Merger Guidelines. Thus, the question here is whether there are **sunk** costs or other barriers to facilities-based entry that will prevent the market from attracting

³¹ *Verizon*, 122 S. Ct. at 1672 n.27.

³² *USTA*, 290 F.3d at 421.

³³ *Id.* These holdings expressly foreclose Mr. Barr’s claim (at 3) that an element must be found to be a natural monopoly before impairment can be found, and that the Act requires a showing that average costs are declining throughout the range of **the** relevant market, such that an entrant with less than **full** market scale cannot compete.

³⁴ 15 FCC Rcd. 3696 (1999)

³⁵ *Id.* ¶¶ 75-71.

³⁶ *Id.* ¶ 78.

³⁷ See, e.g., United States Department of Justice and the Federal Trade Commission, *Horizontal Merger Guidelines*, §§ 12.1, 3.3 & n. 31 (rev. Apr. 8, 1997) (“*Merger Guidelines*”).

multiple competitors and becoming unconcentrated and workably competitive (*e.g.*, with five or more firms) in the near term (*i.e.*, in the next two years) if access to **UNEs** is

Access to UNEs as a Means to Attain Scale And Time To Build – *USTA* undercuts any claim that scale economics are irrelevant to the Commission’s impairment **analysis**.³⁹ *USTA* held only that access to UNEs cannot be ordered when new entrants and incumbents face effectively identical costs and when the incumbent’s scale advantages are transient and small **so** that competitive supply by multiple firms would not be wasteful. In this circumstance, there **is** no entry barrier to facilities-based **service** and **no** impairment. **By** contrast, however, there are obvious entry barriers and impairment when entry requires large sunk investments, when entrants face significant costs that the incumbents do not, or when incumbents have other first mover advantages (*e.g.*, automatic rights of ways and building access rights that competitors must spend time and money to acquire). For example, because they will otherwise be wasteful, sunk investments in transport facilities between two offices simply cannot rationally be made unless the requesting carrier has used UNEs to build up necessary traffic volumes and to serve customers during periods in which rights **of way** *are* acquired and construction concluded. Critically, the D.C. Circuit *acknowledged* that a legitimate benefit of UNEs is that they “may enable the CLEC to enter the market gradually by building a customer base up to the level where its **own** investment **would** be **profitable**.”⁴⁰

In this regard, the Commission should reject any claim that access to UNEs can never be granted on the grounds that CLECs need to build up a customer base and “**scale**” before construction can be economic or that “time to build” is required **thereafter**.⁴¹ This is plainly wrong under *USTA*. Mr. Barr’s other assertion – that concededly unprofitable resale is the exclusive means **of** building up the necessary **scale** – is not only **also** rejected by *USTA*, but is foreclosed by the Act’s terms and structure. As the Commission **has** stated many times, the Act provides three means of entry – facilities, **UNEs**, and **resale** – and intends that each be available and that CLECs may use whichever is most profitable. Resale, moreover, offers no substitute for **UNEs**. Resale discounts **apply** only to retail exchange services, not to exchange access services that help fill transport, loop, and **other** facilities and that are critical to establishing **the** volumes that can allow carriers to justify and build their own facilities. In addition, resale does not provide CLECs with **any** information about the distribution of traffic and the traffic volumes on particular **routes** that is a precondition to a decision whether facilities will be economic to **serve** particular routes or particular customers. And resale does not **permit** CLECs to **offer** innovative new services to differentiate itself from the **ILEC**.⁴² **Thus**, it is only through the leasing of

³⁸ *Cf. H. § 1.5* (concentration). *§ 3.2* (to be relevant, **entry** must **occur within two years**), *§ 3.4* (to be relevant, entry **must** be sufficient to prevent supracompetitive pricing).

³⁹ Barr Letter at 3-4, 6-7.

⁴⁰ *USTA*, 290 F.3d at 424.

⁴¹ Barr Letter at 3-4, 6-7.

⁴² AT&T Comments, Huel Dec. ¶ **25** (Apr. 5, 2002).

UNEs that CLECs can acquire the traffic volumes and information that will allow alternative facilities to be deployed as soon as, and to the extent that, they are justified.

Attempts to **analogize**⁴³ local competition to the experience in cellular and PCS competition, which assertedly required large “network” investments and did not achieve profitability for five-to-ten years periods, could not be more inapt. As a threshold matter, wireless service is simply not a full product substitute for local wireline voice service, and there is **no** evidence that a substantial proportion of wireless **users** have abandoned their wireline service. But more fundamentally, ILECs have facilities in places that can **service** the *entire existing and foreseeable demand* in the market. Thus, absent UNEs, new entrants could only enter by making **sunk** investments to create excess capacity, and they would face substantial risks – which the incumbents had not – that **the necessary traffic** volumes would not materialize, or that the ILEC would respond to their entry by pricing its service at marginal **costs**.⁴⁴ By contrast, when **new** wireless **entry** was authorized in the **mid-1990s**, the ILECs were subject to spectrum caps, so that they did not have -- and could not even build – the capacity required to meet the existing market demand, much **less** the rapidly growing future demand for wireless services. Thus, PCS providers could make facility investments secure in the knowledge that they were not creating excess capacity and that their facilities would be filled with traffic at compensatory rates. Indeed, the fact that PCS providers reinvested their net operating income reflected the rapid growth in demand.

The ILECs thus have things backwards in asserting that **new** entrants have had “six years” to build facilities and cannot claim to need additional “time to build.” Local telephony is a market in which large fixed and **sunk** investment cannot **even** rationally be planned until a carrier has acquired, or is certain to acquire, the necessary customer base to support new **construction**.⁴⁵ And even then it takes significant time for the carrier to obtain **the** necessary rights of way and/or building access rights and to complete construction. For example, AT&T has shown that a carrier cannot rationally construct transport facilities **on** a particular point-to-point route **unless** and until it has achieved the minimum **traffic** volumes – about 18 DS3s – that make such facilities **economic**.⁴⁶ As *USTA* acknowledges, one of the legitimate benefits of UNEs is that they allow gradual entry into markets that require **sunk** investments.

Impacts of Intermodal Competition on the Impairment Analysis – The question under the Act, strictly speaking, is not whether the incumbents’ precise facilities can **be** replicated, but whether there are alternative **sources** of *their functions* that **can be** economically used to provide a competitive local **service**. Intermodal competition is thus

⁴³ *Barr* Letter at 3.

⁴⁴ See *UNE Remand Order*, ¶¶ 75, 77.

⁴⁵ See AT&T Reply Comments, Willig Reply Dec. ¶¶ 18-36 (July 17, 2002); AT&T *Ex Parte*, Comparing ILEC and CLEC Network Architecture, at 22-23 (Oct 3, 2002) (“*AT&T Network Architecture Ex Parte*”); AT&T *Ex Parte*, Loop Unbundling and Impairment, at 7-10 (Oct 7, 2002) (“*AT&T Loop Unbundling Ex Parte*”).

⁴⁶ *AT&T Network Architecture Ex Parte* at 14

potentially relevant to the Commission's analysis. But to be *actually* relevant, the internodal alternative must be actually available *today*, it must be an exact **or** close substitute for the functions of ILECs' facilities, and there must be sufficient **existing** alternatives, in aggregate, to satisfy the Act's object of **multiple** competing **firms**.

Against this standard, the **Commission** must dismiss out-of-hand attempts to rely on satellite technologies that are "in development" or fixed wireless solutions that are "**promising**."⁴⁷ It must also reject the claims based on mobile cellular and PCS **services**, for they do not remotely provide services of the reliability and quality of landline networks. In this regard, the present substitution of wireless for landline minutes occurs **only** for marginal traffic, and associated **losses** do not remotely establish that wireless carriers can or should be treated as providing competitive exchange and exchange access services. In this regard, mobile services could not be offered at close to today's prices if they were engineered to provide landline reliability and quality – even if that were technically feasible.

The Bell arguments on "internodal competition" boil down to the potential for cable telephony. The Bells may well be correct that cable operators' ability to upgrade facilities that provide video services to offer telephony means that the incumbent facilities are, strictly speaking, "not a natural monopoly."⁴⁸ But even if true, that is irrelevant under the Act, and under *USTA*. Even in the limited areas where the cable providers **have** in fact effected the necessary upgrades and provide competing service, that **means** only that a limited number of residential (but not business) service is served by a duopoly. **As** the Commission has held in the past – and reiterated in the very recent Echostar – Direct TV Order – duopolies are **insufficient** to create the competition that is the object of the *Act*. **As** Chairman Powell there aptly stated, allowing a duopoly:

would decrease incentives to reduce prices, increase the risk of collusion, and inevitably result in **less** innovation and fewer benefits to consumers. That is the antithesis of what the public interest demands."

Further, virtually all of the cable telephony available today is provided in only some of the areas served by only two operators (AT&T Broadband and **Cox**),⁵⁰ and it is speculative whether or when other operators will make the necessary upgrades. NCTA's statistics indicate that **cable** providers offer cable telephony to residential customers in only about **30** cities in **15** states.⁵¹ And as explained at the October 7, 2002 *En Banc* Hearing on Steps Toward Recovery in the Telecommunications Industry, cable operators can expect to

⁴⁷ *Barr Letter at 5*.

⁴⁸ *Id.* at 4.

⁴⁹ Statement of Chairman Powell, *Application of EchoStar Communications Corporation (Echostar); General Motors Corporation and Hughes Electronics Corporation (DirecTV)*, CS Docket No. 01-348 (Oct. 10, 2002).

⁵⁰ *AT&T Ex Parte*, Correcting the RBOCs' Empirical Analyses of the Linkage Between UNE-P and Investment, at 14 (Oct. 23, 2002) ("AT&T UNE-P and Investment *Ex Parte*").

⁵¹ See www.ncta.com/broadband/broadband.cfm?broadbandID=3

face severe capital constraints for the next few years, and because their services **are** under severe attack from satellite services with more channels, the best **use** of such future capital will likely be to invest in enhancing their video **services**.⁵²

Finally, even the incumbents do not assert that cable telephony facilities **are** available for lease to competitors – at any price. Thus, the incumbents are reduced to claiming that **CLECs** should overbuild cable systems to provide video **services** in competition with incumbent cable **TV** systems (and DBS providers) and then invest in upgrades that allow telephony and video to be provided over their cable facilities. **This** is nonsense, because it means that **CLECs** would have to make **sunk** and potentially wasteful investments on a “field of dreams theory” in two markets, not just one.

Potential Countervailing CLEC Advantages – **USTA** stated that the **Commission** should consider whether **CLECs** have advantages of their own that **offset** the **cost** advantages that incumbents enjoy and whether there is “net impairment.” But **the** only potential offsetting advantage that the court identified is that **CLECs** have theoretical advantages in serving business customers because they have no duty to **serve** “rural or residential customers” at rates that are below-cost and that are subsidized by above-cost rates to business customers. And the incumbents fail to point out that they **are the** beneficiaries of high-cost support mechanisms for serving such customers. **Further**, even if the existence of implicit subsidies were assumed, **§ 254** of the Act requires that they be eliminated and replaced with explicit subsidy mechanisms, which is why the **Supreme Court** held that such subsidies are irrelevant to unbundling determinations.”

But this is all beside the point. **AT&T** has demonstrated that **CLECs** are impaired in serving business customers through alternative facilities at *existing* retail rate levels that include any existing implicit subsidies that have not been eliminated. **For** example, **AT&T** has shown that **CLECs** cannot overcome the incumbents’ scale economies by serving customers from many local serving offices with a single switch, because the additional costs of backhaul make the service wholly uneconomic.⁵⁴

Other potential sources of countervailing advantages are nonexistent, irrelevant, or both. The assertion that **ILECs** “face diseconomies of scale associated with a **large** embedded **network**”⁵⁵ has no empirical basis. **As** **AT&T**’s unrebutted network architecture evidence establishes, the **ILECs**’ economies of scope and scale give them inherent cost advantages over **CLECs** over all levels of demands. **AT&T** has demonstrated that even very successful competitors have significantly higher unit costs. **For** example, a **CLEC** that secures even a **30%** market share would have per line loop costs that **are 57%** higher

⁵² **Oct. 7, 2002 FCC En Banc**, Tr. at 79-80 (~~statement~~ of Lara Warner, **CSFB**).

⁵³ ***AT&T Corp. v. Iowa Utils. Bd.***, 525 U.S. 366, 393-94 (1999).

⁵⁴ ***AT&T Loop Unbundling Ex Parte*** at 12, 13 (showing that in order to overcome a \$3/month backhaul penalty a **CLEC** would have to achieve a 10% market **share** of business customers in 38 central **offices** of 25,000 average local **VGEs**).

⁵⁵ Barr letter, at 5

than the ILEC's if it were to attempt to self-deploy its own loop network and 178% higher costs than the ILEC's if it were to self-deploy its own transport network."

The assertion that AT&T and other CLECs who are national interexchange carriers have "countervailing advantages" that offset the ILECs' cost advantages in providing local services to "enterprise customers" is **nonsense**. ILECs have been excluded from interexchange markets precisely because their control over essential exchange access facilities would give them **immense** and uncontrollable advantages in providing interexchange service to these customers, and BOCs that receive § 271 authority have the same ability to acquire capabilities required to provide interexchange **services** to "enterprise" customers as did Sprint, WorldCom, and AT&T itself. Indeed, the Bells have the advantage of being able to take advantage of an existing wholesale market that will enable them to acquire capacity at enormous market-driven discounts to compete for those customers without spending a penny **on infrastructure investment**.⁵⁷ Moreover, as explained below, unless AT&T and other IXC's *can* obtain loop-transport combinations and other UNEs to serve these enterprise customers at similar cost-based rates, they will be severely impaired in providing **both** local **and** long distance services in competition with incumbents, for they can be victims of the types of price squeezes that have enabled incumbents to monopolize the provision of the intraLATA **frame relay services**.

comparative Impairment – AT&T's evidence establishes that incumbents' inherent loop access and cost advantages would erect the **barriers** to facilities-based service even for customers served at prevailing business rates. Thus, it is quite plain that denying access to **UNEs** would severely impair **CLECs'** ability to serve residential customers, even if all subsidies were eliminated.⁵⁸

Market Specific Variations In Assessing Competitive Impairment – Finally, **USTA** explicitly requires the Commission to consider "market specific variations in competitive impairment."⁵⁹ Thus, the Commission cannot decline to require unbundling by lumping all classes of customers together and adopting rules of unvarying scope for **all** that **are** based on factors applicable only to some. But despite the D.C. Circuit's requirement of "granularity," the incumbents, as exemplified by Mr. Barr's letter, have responded to this mandate by proposing *national* markets and relying **on** national statistics – many of which

⁵⁶ AT&T Comments, Clarke Dec. ¶ 30 (Apr. 5, 2002).

⁵⁷ *Verizon Expands Voice, Data Services*, B. Bergenstein, AP, November 4, 2002

⁵⁸ The **Bells** are correct (Barr Letter at 5-6) that transient burdens that equally apply to incumbents and new entrants erect no **entry** barriers under **USTA** and cannot be a basis for **finding** impairment. But AT&T **has not** relied **on any** such burdens in making impairment showings here. Indeed, **wen** if there **were** actual proof to support **ILEC assertions** that **overall** some residential rates **are** below cost – and there is **none** – AT&T's evidence of impairment **is not** based **on** such rates.

⁵⁹ Of course, if impairments exist for an entire category of customers, **USTA** clearly permits the Commission to find impairment for all **such** customers.

have been shown to be inaccurate⁶⁰ – to contend that CLECs will not be impaired in providing local service to any class of customers.

This is flatly improper. The issue under the Act is whether **UNEs** are necessary to remove barriers to the provision of exchange, exchange access, and other telecommunications services in competition with incumbents. Decisions to offer these services are made at the level of individual local serving offices and depend on whether a CLEC can achieve unit costs that are at or near the incumbent's if the CLEC realizes reasonably achievable shares of the relevant classes of customers. This **turns** on engineering, economic, and operational facts that vary with volumes of traffic generated at specific customer locations and the specific facilities that are used to provide those customers with telecommunications services. These are the sources of "variations" in "competitive impairment," and any impairment analysis is required to consider these market-specific variations.

AT&T and others, in conformity with *USTA's* requirements, have specifically demonstrated how the natural monopoly characteristics that are peculiar to the local exchange business, impair their ability to serve specific classes of customers without access to each of the individual UNE and UNE combination they **seek**.⁶¹ The incumbents, however, have offered no response to these specific showings other than to cite general statistics regarding CLEC facilities deployment. Since the CLECs' showings **are** uncontested, they must be accorded dispositive weight.

Application Of The Impairment Standards To Specific UNEs

The application of the above criteria to the specific facilities at issue is quite straightforward.

Loops - Copper loops (whether voice grade (DS0) or DS1) are quintessential natural monopoly facilities, because they are used to provide low volume telecommunications services. The only loops for which competitive supply is ever economically possible are certain very high capacity (DS3 and higher) facilities in limited conditions. But whether a CLEC can provide these facilities at unit costs close to the incumbent's depends on such factors as their capacity, length and proximity to splice points on fiber rings,⁶² meaning that competitive supply of these facilities will often be uneconomic. In all events, even when competitive supply may be economic, ILECs

⁶⁰ See *generally* AT&T Reply Comments, Pfau Reply Dec. (July 17, 2002).

⁶¹ See AT&T Reply, Willig Reply Dec. ¶¶ 37-44 (July 17, 2002); AT&T *Ex Parte, Economic Analysis of Impairment*, at 4-7 (Oct. 11, 2002); *AT&T Network Architecture Ex Parte* at 20-21; *AT&T Loop Unbundling Ex Parte* at 23; AT&T *Ex Parte, Transport UNEs are a Prerequisite to the Development of Facilities-Based Local Competition*, at 3-10 (Oct. 7, 2002) ("*AT&T Transport Unbundling Ex Parte*").

⁶² See AT&T Loop Unbundling Ex Parte at 23; AT&T Reply Comments, Fea-Giovanucci Reply Dec. ¶¶ 24-68 (July 17, 2002).

benefit from significant right of way, building access, and other first mover advantages, and constructing loops requires ~~large~~ fixed investments that are **sunk** and that will **be** wasted if entry is unsuccessful.⁶³ **As** a result, the facilities often cannot be built at all.

In addition, investments in high capacity loop facilities will never be economic unless the CLEC can be assured that it will have the committed customer base to allow it to recover its substantial **sunk** costs. **This** often means that carriers must first **use** UNEs to build **up** the required customer base and/or to provide service until rights of way and access rights **are** obtained.

Transport- Transport facilities **are** dedicated point-to-point facilities that connect one specific office to one other office. In order for a competitive **carrier** to construct such facilities, it must incur enormous fixed and **sunk** investments to install a facilities-based collocation in a local serving office and to construct transmission lines to connect that office to the other specific office. AT&T has shown that it is not economic for a competitor to incur the costs of connecting a collocation to its **own** transport facilities unless it requires about 18 **DS3s** (over **36,000** VGEs) **of traffic**.⁶⁴ Self-provisioning transport further requires that CLECs obtain rights of ways that ILECs acquired at **low** (or no) cost and as matters of **course** due to their first mover advantages.

The Bells' own data acknowledge that there are two or more facilities-based collocations in no more than **20%** of incumbents' wire centers in the **25** largest **MSAs**.⁶⁵ They also admit that they have no data as to whether those collocations **are** equipped to carry **DS0** and **DS1**, as well as **DS3** levels of traffic.⁶⁶ They further admit that although there are often connections between these offices and IXC's **POPs**, they have no data regarding the existence of fiber transport connections between these offices and **any** other specific offices that CLECs need to reach in order to **serve** their **own customers**.⁶⁷ Carriers that have supplied comments to the Commission, however, have demonstrated that they have **no** alternatives to ILECs' transport facilities – at any level – in the vast **majority** of cases.⁶⁸

⁶³ See AT&T Reply, Willig Reply Dec. ¶¶ 37-39 (July 17, 2002)

⁶⁴ *AT&T Network Architecture Ex Parte* at 14. Given the amount of traffic this represents, a carrier could **not** expect to aggregate such volumes unless it has the ability to create "hubs," **which** themselves will have higher **unit** costs than the incumbents unless they **can** be obtained at TELRIC rates.

⁶⁵ ILEC **Fact** Report, at III-3 (Table 2) (Apr. 5, 2002) (attached to comments of BellSouth, Verizon, SBC).

⁶⁶ Verizon *Ex Parte*, UNE Rebuttal Report 2002, at 40 (Oct. 23, 2002) ("ILEC UNE Rebuttal Report").

⁶⁷ *Id*

⁶⁸ See, e.g., AT&T Reply Comments at 257-67 (July 17, 2002) (citing and **summarizing** comments).

But the Bells claim the *Special Access Pricing Flexibility Order*⁶⁹ establishes that the provision of transport is “competitive” wherever they have met the Commission’s standards for pricing flexibility. This contention is extraordinary. The Order adopts triggers that are met in an area if there are collocations in only **15%** of the ILEC’s offices, or in offices representing only **30%** of special access traffic in that area. Thus, **the** Commission’s pricing flexibility rules apply even when **85%** of the offices in an area or offices covering 70% of the special access **traffic** in an area *face no facilities-based competition* at all. And critically, the Order specifically states that satisfaction of these triggers does *not* establish that incumbents lack market power, and the RBOCs’ own data show that they are earning on average a **37.5%** rate of return on special access, even on an embedded cost **basis**.⁷⁰ It would thus be inconsistent both with the Commission’s own rulings and actual market experience to support the incumbents’ claims that special access services are competitive.

Moreover, the incumbents propose to remove access to high capacity transport **as** a UNE when there are competitive facilities at only *one end* of the route a requesting carrier needs. Thus, they *assume* that the facilities-based competitive carrier would be both willing and able to construct facilities to the location where the requesting carrier needs them without any investigation at all into the economics or practicalities of such construction, or whether capital is available to support such construction. And in the meantime, the incumbents would relegate the competitor to the use of high priced and non-competitive special access services. The Commission thus cannot find here, contrary to its own conclusions in the *Special Access Pricing Flexibility Order*, that the mere compliance with the pricing flexibility rules means that requesting carriers are not impaired without access to unbundled transport at cost-based rates.

Accordingly, transport plainly must continue to be made available as a UNE at cost-based rates. The only possible legitimate carve out would be for point-to-point routes on which (1) a CLEC has sufficient traffic (at least **18 DS3s**) to make facilities construction economically feasible and there are no right of way or other practical impediments to such construction **or** (2) there are at least four competing carriers on a specific route with sufficient capacity at the level requested by the CLEC, again assuming that there are no operational **or** practical hurdles to using such alternatives.

Switching - Switching requires significant fixed investments that are largely **sunk e.g.**, collocations and many of the costs of the switch itself, including the cost of installation and engineering it for a specific location. But **the** clearest source of impairment in providing switching is related to CLECs’ inability to connect retail customer loops to competitive switches. The source of this impairment is the CLECs’ inability to provide their own loops, the inherently inferior access they have to incumbents’ loops, and **the** high cost of backhauling the traffic on such loops to the competitive switch.

⁶⁹ 14 FCC Rcd. 14221 (1999).

⁷⁰ See Petition of AT&T, RM No. 10593, at 7-11 (filed October 15, 2002) (“AT&T Special Access Petition”).

The incumbent networks are designed **so** that their loops almost always end in the central office where their local serving switch is located. ILEC voice grade loops **are** connected to ILEC switches through the use of a simple jumper wire pair across their main distribution frame. And in the vast majority of *cases*, the jumper is already in place. But that is never true for CLECs. **In** order for a competitor to connect an unbundled ILEC voice grade loop to its switch, the CLEC faces two different categories of significant impairments that the incumbent does not. These disadvantages constitute substantial barriers to their ability to enter the market through the use of unbundled loops and non-ILEC switches.⁷¹

The **first** is the costs of “backhaul.” To replicate the function **of** the ILEC jumper, *i.e.*, to connect its customers’ loops to a competitive switch, a CLEC must install collocations in each office it serves (**unless** loop-transport combinations are practically available), install transmission equipment, and use transport facilities to route its customers’ traffic to the location where its switch is housed.⁷² **This** backhaul “penalty” applies to all customers and all switched services, but it is especially prohibitive for customers served by voice grade loops. These additional costs range from nearly \$7 per month per loop to more than \$20 per month per loop, even where a competitor serves thousands of loops from the same LSO.

Second, disconnecting voice grade loops from the incumbent’s switch and connecting them to the CLEC’s network today requires the incumbent to perform a manual hot cut that (1) is time consuming, risks service disruptions, and has caused a very significant proportion of AT&T’s customers to cancel service before it could provide service and (2) carries a significant fixed (and **sunk**) cost penalty that **can** be as **high** as \$180 per loop. These hot cut disruptions and costs will continue **unless** and until an electronic form of loop provisioning is implemented, **so** that CLECs seeking to sign up local customers can **be** on an equal footing with ILECs that enter the long distance business. Moreover, for customers served by DLC loops, there is generally no way to provide the same quality of service to a customer using a competitive switch.”

Whether these undisputed entry barriers are generally surmountable for any class **of** customer locations depends on the applicable cost disparities and revenue opportunities that such customers represent at today’s rates. **For** certain large volume business customers, CLECs can overcome these disparities to **serve** customer locations that **use** DS1 or higher capacity loops (which do not require hot cuts) and that employ special customer premises equipment such as PBXs. But the combination **of** the backhaul penalty and the hot cut penalty create significant impairments for competitors that **seek** to provide voice.

⁷¹ See *AT&T Network Architecture Ex Parte* at 19-21. **These** impairments apply whether a CLEC **uses** its own switch or **the** switch **of** a third party. Indeed, **the** presence of **such** impairments largely explains why **a** competitive market **for** unbundled switching has never developed.

⁷² Transport equipment and backhaul facilities have very high fixed **costs**. **Thus**, in order to be economic **they must have** very high capacity.

⁷³ AT&T Reply Comments at 74 (July 17, 2002).

grade service to residential and small business customers through the use unbundled loops and non-ILEC switches.

UNE-P- For the same reasons, CLECs will **be** severely impaired in providing mass market services to residential and small business customers **unless** they have access to combinations of loop, switching, and shared transport that are referred to as UNE-P. This follows from the facts that ILECs have monopoly control over loops and transport and that there are absolute economic and operational barriers to competitors' efforts to **serve** customers by connecting self-provisioned switches to the monopoly loops and **transport**.⁷⁴ Indeed, the record could not **be** clearer that adoption of the ILECs' **proposal** to end UNE-P would devastate the emerging competition for residential and small business customers, nearly all of which is based on **use** of the UNE Platform.

At **the same** time, it **is** critical to underscore that entry through **UNE-P** requires hundreds of millions of dollars of investments that are fixed and **sunk**, and additional **fixed** and **sunk** investments must be made before **UNE-P** based services can be extended to an additional state. Accordingly, even UNE-P entry is not economic without sufficient **scale** to support the significant costs to develop the necessary infrastructure to serve local voice customers. In addition to these substantial fixed investments, the provision of **UNE-P** also requires AT&T and other CLECs to lease ILECs' loop, transport, and switching facilities at wholesale rates that have been found by each of the relevant State commissions to cover all the incumbents' economic costs, to provide them a reasonable profit and to satisfy the ratemaking method that the United States Supreme Court upheld only last May in **Verizon**.

Because of their ability to **use** UNE-P, AT&T and other competitors have been able **to offer** consumers competitive services. Because incumbents have in many cases responded to this competition by cutting their **own** prices, experience also **confirms** that incumbents' rates have been excessive. Eliminating **UNE-P**, whether immediately or after some transition, would have the effect of depriving consumers of these benefits. AT&T and many other CLECs that rely on UNE-P would then be forced to **abandon** the local services that they are now providing to millions of residential households and **small** business customers in many states across the country, requiring these customers to return to incumbents.

Finally, UNE-P is an essential feature of the *quid pro quo* embodied in § 271 of the Act. The reality is that the intensely competitive wholesale long distance market enables

⁷⁴ In their UNE Rebuttal Report (**at 16, 39**), the ILECs attempt to refute these points by identifying a **single** CLEC (Cavalier) that currently serves residential as well **as** business customers through combinations of self-provisioned switches and unbundled loops. But Cavalier **offers** residential service only to customers who make two-year commitments to obtain packages of **Internet** Access, long distance and local. **See** www.cavtel.com/residential/res_9a.php (visited on Nov. 6, 2002). **Thus**, it **is** obvious that Cavalier has NOT **made a mass market offering**. **Moreover**, AT&T believes that even Cavalier's targeted offering to this small subset of higher volume residential customers cannot be profitable, due to the backhaul and hot cut **cost** penalties. By contrast, AT&T's **UNE-P** services are purchased by all classes of residential customers in **high** density **and** low density areas of States. For example, in New York, AT&T **has** comparable penetration rates **among** customers **in** all density **zones**.

incumbents to enter the long distance market by obtaining capacity at wholesale and reselling it. And because customers generally desire one stop shopping, BOCs have acquired extraordinary market shares of long distance in each market in which § 271 authority has been granted. In those states where UNE-P is available at economic rates, it has given AT&T and other IXC's comparable opportunities to provide local services and to offer packages of local and long distance.⁷⁵ The elimination of UNE-P would thus enable BOCs to leverage local monopolies to foreclose competition in long distance markets, contrary to the whole object of § 271.

Loop-Transport Combinations (EELs) and Special Access - The Commission's existing rules adopt (1) use restrictions that prohibit requesting carriers from using loop-transport combinations (also referred to as enhanced extended links or EELs) solely to provide the equivalent of special access services that connect IXC's to their end user customers and (2) commingling restrictions that have meant that these combinations generally cannot be used to serve local customers with DS1 or higher capacity facilities. Indeed 98% of AT&T's DS1 facilities that it uses to provide local services are today obtained at inflated special access rates.⁷⁶ These restrictions have severely impaired the provision of both interexchange and local service.

First, it has led to price squeezes that have already foreclosed competition to large enterprise customers. Specifically, when BOCs were barred by § 271 from offering interexchange Frame Relay and similar services, IXC's had immense - and legitimate - advantages of scope economies in providing intraLATA Frame Relay Services. But by denying them access to loop-transport combinations and requiring the use of special access instead of UNEs, incumbents imposed price squeezes that have allowed BOCs to acquire 90% shares of intraLATA and local Frame Relay Service - as AT&T has documented elsewhere." Where BOCs have been granted § 271 authority, they are using the same price squeezes to obtain illicit advantages in providing interexchange frame relay services. For example, despite the absence of investment in national facilities in this market, Verizon has recently touted the successes it is attaining in this market.⁷⁸ But share gained through illicit use of monopoly facilities is anticompetitive - and is precisely what § 251 is designed to prevent.

As the Commission and the Supreme Court have concluded, TELRIC represents the economic costs that the ILECs incur using their facilities to provide their own services, and the ILEC price their own services based on these economic costs.⁷⁹ By forcing IXC competitors to obtain these essential inputs at special access rates that are substantially higher than UNE rates, the incumbents have created price squeezes that severely impair

⁷⁵ See *AT&T Corp. v. FCC*, 274 F.3d 549, 554-56 (D.C. Cir. 2001) (FCC must address whether UNE-P rates provide sufficient margins to allow IXC's to offer competing local services).

⁷⁶ *AT&T Transport Unbundling Ex Parte* at 10.

⁷⁷ See, e.g., Comments of AT&T Corp. CC Docket No. 01-337, at 24-25 (March 1, 2002).

⁷⁸ *Ex Parte* letter from Joan Marsh to Marlene Dortch (Oct. 29, 2002).

⁷⁹ *Local Competition Order*, 11 FCC Rcd. 15499, ¶¶ 679-93 (1996); *Verizon*, 122 S. Ct. at 1668-73.

IXCs' ability to compete on the merits. In this regard, it is besides the point that the Commission's existing § 272 rules require BOCs to provide service through separate affiliates that must "purchase" access services at generally applicable tariffed rates. While the separate affiliate requirements prevent some forms of blatant price discrimination, the access charges that a BOC's interexchange subsidiary pays to its affiliate is a "left pocket-to-right pocket" intracorporate transfer payment, and the retail interexchange prices of the BOC are unregulated and set based on the overall costs of the service to the BOC enterprise.

Similarly, the commingling restrictions have had the practical effect of barring AT&T from using loop-transport combinations to connect its local service customers served by DSI and higher capacity loops to AT&T's switches and to require the use of special access that costs up to twice as much. This significantly inflates AT&T's costs of serving its local customers and has meant that AT&T cannot economically serve many other local customers, and plainly means that denials of access to loop-transport combination impairs AT&T's provision of local service.

In addition, AT&T has shown that the imposition of use and commingling limitations limits the growth of facilities-based competition – the very type of competition the incumbents claim to support. In particular, these limitations make it significantly more expensive for carriers to aggregate customer traffic and create efficient "hubs" where they can afford to create additional facilities-based competition." Thus, rather than provide incentives for other carriers to construct new facilities, the use and commingling restrictions simply create additional roadblocks to the deployment of efficient competitive networks.

Indeed, the Commission has previously recognized that loop-transport combinations can reduce competitors' backhaul penalty (by eliminating the need to collocate in every end office where a competitor wishes to compete) and are critical to support competitive switch-based service.⁸⁰ Yet as the ILECs admit, the incumbents generally chose to refuse to provide these combinations and instead provide unbundled switching. Given the incumbents' staunch opposition to the unbundling of local switching and UNE-P, the only rational basis for this refusal would appear to be that the benefits of keeping such combinations from competitors were even greater than the effects of competition from UNE-P.

Finally, it is ironic in the extreme that the incumbents would contend that the availability of tariffed special access services has any effect at all on the incumbents' obligation to provide loop-transport combinations as UNEs. As AT&T has elsewhere demonstrated, the incumbents' special access services are today priced at exorbitant levels that are up to two times the costs of UNEs under TELRIC.⁸² More generally, because

⁸⁰ AT&T Reply Comments, Fea-Giovanucci Dec. ¶¶ 69-76, Willig Reply Decl. ¶47 (July 17, 2002).

⁸¹ *UNE Remand Order* ¶ 278 (existing exception from the requirement to provide unbundled switching carve out applies only if "cost-based" loop-transport combinations are available).

⁸² AT&T Special Access Petition at 10

§ 251(c)(3) of the Act requires that UNEs be available at TELRIC-based rates, it is patent that incumbents cannot avoid their statutory obligations by offering the capabilities of UNEs in wholesale services that **are** available under tariff at higher rates. The Commission first rejected this contention in its *Local Competition Order* (§ 287), and the Eighth Circuit “agree[d]” that relieving incumbents of UNE requirements on the ground that a UNE’s functionality could also be obtained in a tariffed wholesale service “would allow the incumbent LECs to evade a substantial portion of their unbundling obligations under subsection 251(c)(3).”⁸³

NGDLC Loops - Finally, the record clearly reflects the substantial impairments that new entrants face because of the incumbents’ current ability to bar CLECs **from** accessing the high frequency portion of NGDLC loops in ILEC central **offices**. CLECs can no more afford to deploy NGDLC loops than they can afford to deploy any other **type** of loop, and the record shows that the costs and technical impediments associated with constructing remote collocation facilities are prohibitive. Moreover, the incumbents’ efforts to paint the remote electronics used in NGDLC loops as “packet switching” are utterly wrong, NGDLC loops – as all other loops – provide no switching **functionality**.⁸⁴ Moreover, it is undisputed that CLECs that wish to provide competitive DSL service must **use their own** packet switches, so any attempt to call access to NGDLC loops a form of “data UNE-P” is simply wrong. Finally, AT&T has demonstrated that the incumbents’ ability to wall off access to NGDLC loops has given them enormous advantages in their efforts to compete for local voice services as **well**.⁸⁵ Indeed, incumbent executives have proudly pronounced that their ability to offer DSL service has substantially reduced customer “churn” for local voice services? The case for impairment is clear and the only result of accepting the incumbents’ arguments would be to lock up broadband services for small business customers as an ILEC monopoly and to relegate retail residential broadband services to a duopoly between the ILECs and cable providers.

* * *

In **sum**, the record shows that removal of access to **UNEs** and restrictions on UNE use will not encourage new entrants to construct their own facilities. Indeed, it shows just the opposite. CLECs will only be encouraged to construct **their** own facilities by rules that *foster* their **use** of **UNEs**, so they can develop sufficient scale to support additional facilities deployment, and so that the incumbents’ unit cost advantages arising from their closed network architectures may be somewhat neutralized.

⁸³ *Iowa Utilities Bd. v. FCC*, 120 F.3d 753, 809 (8th Cir. 1997), *aff’d in part and rev’d in part on other grounds*, *AT&T Corp. v. Iowa Utilities Bd.*, 525 U.S. 366 (1999).

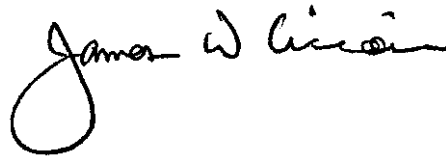
⁸⁴ AT&T Reply Comments, Gerszberg Reply Dec. ¶¶ 3-6 (July 17, 2002).

⁸⁵ AT&T Reply Comments at 102-08, 191-92, 220-23 (July 17, 2002).

⁸⁶ See http://www.isp-planet.com/cplanet/tech/2002/prime_letter_020729_verizon.html (“SBC just reported DSL customers have a remarkable 75 percent lower churn rate for **voice** lines.”)

For these reasons, the Commission should reject the incumbents' proposals. Instead, it should adopt rules that (1) maintain its existing national list of UNEs; (2) modify the switching carve-out so that it applies to all customer locations served by DS1 and higher capacity loops; (3) eliminate the use and commingling restrictions **on loop-**transport combinations; and (4) eliminate the restrictions **on** access to **NGDLC** loops.

Very truly yours,

A handwritten signature in black ink, appearing to read "James W. Linn". The signature is fluid and cursive, with a large loop at the beginning.

cc: [illegible]

cc: [illegible]